

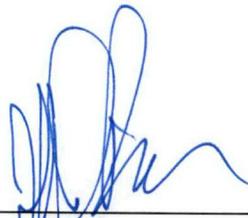
COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

ALTERNATIVE RATE ADJUSTMENT FILING OF) CASE NO.
SOUTH HOPKINS WATER DISTRICT) 2015-00154

NOTICE OF FILING OF COMMISSION STAFF REPORT

Notice is hereby given that, in accordance with the Commission's Order of June 26, 2015, the attached report containing the findings of Commission Staff regarding the Applicant's proposed rate adjustment has been filed in the record of the above-styled proceeding. Pursuant to the Commission's June 26, 2015 Order, South Hopkins Water District ("South Hopkins") is required to file written comments regarding the findings in this report no later than August 28, 2015.



Jeff Derouen
Executive Director
Public Service Commission
P.O. Box 615
Frankfort, KY 40602

DATED **AUG 12 2015**

cc: Parties of Record

STAFF REPORT
ON
SOUTH HOPKINS WATER DISTRICT
CASE NO. 2015-00154

South Hopkins Water District (“South Hopkins”), a water district organized pursuant to KRS Chapter 74, provides retail water service to approximately 2,974 customers that reside in the Kentucky counties of Caldwell and Hopkins.¹ It also provides contracted wholesale water service to Caldwell County Water District (“Caldwell County”) and to the cities of Mortons Gap and Earlington.

On May 15, 2015, South Hopkins filed an application with the Commission requesting to increase its retail water service rates by 5.48 percent pursuant to 807 KAR 5:076 to generate additional annual revenues of \$60,148. It did not request to increase its wholesale rate, which is adjusted annually pursuant to a formula that is included in the wholesale contract agreements. The proposed retail rates would increase a monthly bill for 5,000 gallons of water purchased through a 5/8-inch x 3/4-inch meter from \$31.90 to \$33.66, an increase of \$1.76, or 5.52 percent.

South Hopkins based its requested rates on the test year ended December 31, 2014. The financial exhibits shown in South Hopkins’s application that support the requested rates are summarized below in condensed form. Although South Hopkins is requesting an increase only in its retail rates, both South Hopkins’s retail and wholesale operations are accounted for in the exhibit.

¹ *Annual Report of South Hopkins Water District to the Public Service Commission for the Calendar Year Ended December 31, 2014 (“2014 Annual Report”)* at 12 and 55.

Pro Forma Operating Expenses	\$ 1,439,536
Plus: Average Annual Debt Principal and Interest Payments	42,378
Additional Cash Working Capital	<u>8,476</u>
Overall Revenue Requirement	1,490,390
Less: Other Operating Revenues	(58,998)
Interest Income	<u>(3,318)</u>
Revenue Required from Retail and Wholesale Rates	1,428,074
Less: Pro Forma Present Retail and Wholesale Rate Revenue	<u>(1,353,871)</u>
Required Revenue Increase from Retail and Wholesale Sales	<u>\$ 74,203</u>
Percentage Increase	<u>5.48%</u>

South Hopkins allocated the required revenue increase calculated above to its current rate design evenly across the board as shown below.²

	Present Rate Revenue	Proposed Rate Revenue	Revenue Increase	Percentage Increase
Retail Customers - Meter Size:				
5/8" X 3/4"	\$ 923,937	\$ 974,926	\$ 50,989	5.520%
5/8" X 3/4" (Bi-monthly)	11,906	12,564	658	5.530%
1" Meter	45,216	47,722	2,506	5.540%
2" Meter	98,464	103,931	5,467	5.550%
3" Meter	<u>9,523</u>	<u>10,051</u>	<u>528</u>	<u>5.540%</u>
Total Retail Customers	1,089,046	1,149,194	60,148	5.523%
Wholesale Customers	<u>264,835</u>		<u>14,055</u>	<u>5.307%</u>
Totals	<u>\$ 1,353,881</u>		<u>\$ 74,203</u>	<u>5.481%</u>

Because South Hopkins requested to increase only its retail rates, it sought recovery of only \$60,148 of the \$74,203 required revenue increase it had calculated.

To determine the reasonableness of the proposed rates, Staff performed a limited financial review of South Hopkins's test-year operations. The scope of the

² South Hopkins applied the requested percentage increase across the board to its present rates. Due to rounding, the calculated revenue increase for each meter size differs from the percentage increase of 5.48%.

review was limited to determining whether operations reported for the test year were representative of normal operations. Known and measurable changes to test-year operations were identified and adjustments were made when their effects were deemed to be material. Insignificant and immaterial discrepancies were not pursued or addressed.

Staff's findings and recommendations are summarized in this report. Mark Frost and David Foster reviewed the calculation of South Hopkins's Overall Revenue Requirements. Jason Green reviewed South Hopkins's reported revenues and rate design.

Summary of Findings

1. Overall Revenue Requirement and Required Revenue Increase. By applying the Debt Service Coverage ("DSC") method, as generally accepted by the Commission, Staff found South Hopkins's overall revenue requirement to be \$1,460,500 and that a revenue increase of \$47,233, or 3.49 percent, over pro forma present rate revenues of \$1,353,881 is necessary to generate the overall revenue requirement.

2. Rates. The Commission has previously found that the allocation of a revenue increase evenly across the board to a utility's current rate design is appropriate when there has been no evidence entered into the record demonstrating that this method is unreasonable. Finding no such evidence in this case, Staff followed the method proposed by South Hopkins and allocated the \$47,233 revenue increase evenly across the board to South Hopkins's current rate design as shown below:

	Present Rate Revenue	Proposed Rate Revenue	Revenue Increase	Percentage Increase
Retail Customers - Meter Size:				
5/8" X 3/4"	\$ 923,937	\$ 956,173	\$ 32,236	3.490%
5/8" X 3/4" (Bi-monthly)	11,906	12,323	417	3.500%
1" Meter	45,216	46,789	1,573	3.480%
2" Meter	98,464	101,905	3,441	3.490%
3" Meter	9,523	9,858	335	3.520%
Total Retail Customers	1,089,046	1,127,048	38,002	3.489%
Wholesale Customers	264,835	274,074	9,239	3.489%
Totals	<u>\$ 1,353,881</u>	<u>\$ 1,401,122</u>	<u>\$ 47,241</u>	<u>3.489%</u>

Staff agrees that South Hopkins's contracted wholesale rate should not be adjusted in this proceeding and that only retail rates should be increased. South Hopkins relies on the mechanism located in the water purchase contracts to determine the wholesale rate annually. Any increase or decrease in the wholesale water rate should be determined by the formula, which is the same in the three water purchase contracts. The retail rates calculated by Staff are shown in the Attachment to this report and will increase the monthly cost of 5,000 gallons of water purchased through a 5/8-inch x 3/4-inch meter from \$31.90 to \$33.01, an increase of \$1.11, or 3.489 percent. These retail rates will generate approximately \$38,002 in additional annual revenues.

Pro Forma Operating Statement

South Hopkins's Pro Forma Operating Statement for the test year ended December 31, 2014, as determined by Staff, appears below:

	Application Operations	Pro Forma Adjustments	Adj. Ref.	Pro Forma Operations
Operating Revenues:				
Revenues from Water Sales:				
Metered Water Sales:	\$ 1,038,735	\$ 50,311	(A)	\$ 1,089,046
Sales for Resale	274,763	(9,928)	(B)	264,835
Total Revenue from Water Sales	1,313,498	40,383		1,353,881
Other Water Revenues:				
Forfeited Discounts	24,020			24,020
Miscellaneous Service Revenues	29,674	1,470	(C)	31,144
Rents from Water Property	4,400	(4,400)	(D)	0
Other Water Revenues	904			904
Total Other Water Revenues	58,998	(2,930)		56,068
Total Operating Revenues	1,372,496	37,453		1,409,949
Operating Expenses:				
Operation & Maintenance:				
Salaries & Wages - Employees	305,118	3,442	(E)	308,560
Salaries & Wages - Commissioners	18,200			18,200
Employee Pension & Benefits	115,791	5,973	(F)	121,764
Purchased Water	669,357	(23,449)	(G)	
		(17,762)	(H)	628,146
Water Audit Recovery Charge		2,698	(I)	2,698
Purchased Power	54,131	(1,489)	(H)	52,642
Chemicals	446			446
Materials & Supplies	75,708	(6,750)	(J)	68,958
Contractual Services	11,900			11,900
Water Testing	9,270			9,270
Transportation	29,460			29,460
Insurance	34,169			34,169
Regulatory Commission Expense	11,383			11,383
Miscellaneous	5,589			5,589
Total Operation & Maintenance	1,340,522	(37,337)		1,303,185
Depreciation	69,846	7,715	(K)	77,561
Amortization		650	(L)	650
Taxes Other Than Income	29,168	(918)	(M)	28,250
Utility Operating Expenses	1,439,536	(29,890)		1,409,646
Net Utility Operating Income	\$ (67,040)	67,343		\$ 303

(A) Purchased Water Adjustment & Billing Analysis. South Hopkins purchases wholesale water from the Dawson Springs Municipal Waterworks and Sewer System ("Dawson Springs") and the city of Madisonville ("Madisonville"). Effective July 1, 2014, Dawson Springs increased the wholesale rate charged to South Hopkins. In Case No. 2014-00369, the Commission authorized South Hopkins to adjust its retail water service

rates to pass-through this wholesale rate increase.³ Using the billing analysis in the Application, Staff determined that the rates authorized in Case No. 2014-00369 will generate annual revenues of \$1,089,046, requiring an increase to test-year Water Sales Revenues of \$50,311 as shown below.

Test-Year Water Sales at rates approved in Case No. 2014-00369 - Billing Analysis in the Application	\$ 1,089,046
Less: Reported Revenue - Water Sales	<u>(1,038,735)</u>
Pro Forma Adjustment	<u>\$ 50,311</u>

(B) Wholesale Water Sales Revenues. The contract wholesale rate charged to Mortons Gap, Earlington, and Caldwell County was decreased from \$2.79 per thousand gallons⁴ to \$2.69 per thousand gallons on July 1, 2014, and that rate is still in effect. As shown below, Staff determined that test-year revenues should be decreased by \$9,928 to account for this 2014 wholesale rate decrease.

Total Wholesale Water Sold - Gallons	98,451.598
Multiplied by: Current Wholesale Rate - October 15, 2014	<u>\$ 2.69</u>
Pro Forma Wholesale Water Revenue	264,835
Less: Test-Year Reported Wholesale Water Revenue	<u>(274,763)</u>
Pro Forma Adjustment	<u>\$ (9,928)</u>

(C) Miscellaneous Service Revenues. South Hopkins is participating in a pilot program involving the placement of septic tanks in the city of Saint Charles.⁵ South Hopkins is receiving funds for the project “[a]s a sub-recipient from the City of St.

³ Case No. 2014-00369, *Purchased Water Adjustment Filing of South Hopkins Water District* (Ky. PSC Nov. 14, 2014).

⁴ *2014 Annual Report* at 62.

⁵ Report of South Hopkins Water District, Dawson Springs, Kentucky, for the Years Ended December 31, 2014 and 2013, Note K – Construction In Progress, 2014, St. Charles Sewer Project.

Charles whom has a grant agreement with the Kentucky Infrastructure Authority.”⁶ As of the end of the test year, South Hopkins had installed seven septic tanks at a cost of \$51,738.

South Hopkins is responsible for maintaining the septic tanks and it charging each owner a \$30 monthly fee for this service. In the test year, South Hopkins collected \$1,050 in revenues for the septic tank maintenance, but it has not incurred any offsetting maintenance expenses to date. Using the seven septic tanks that are in operation and the monthly \$30 fee, Staff calculates that annual septic tank revenue is \$2,520. To reflect the normalized revenues from this fee, Staff is increasing miscellaneous service revenues by \$1,470.⁷

(D) Rents from Water Property. South Hopkins reduced test-year other operating revenue by \$4,400. This revenue was generated through the rental of water storage tank space for cellular phone antennas that South Hopkins will no longer receive due to expiration of its contract with Nextel WIP Lease Corp. (“Nextel”) on July 31, 2014. Nextel informed South Hopkins that the contract would not be renewed. Staff finds that the adjustment requested by South Hopkins is appropriate.

⁶ *Id.*

⁷

Septic Tank Fee	\$ 30
Multiplied by: Number of Tanks In Service	<u>7</u>
Monthly Collections	210
Multiplied by: 12 Months	<u>12</u>
Annual Septic Revenues	2,520
Less: Test Year Revenues	<u>(1,050)</u>
Pro Forma Adjustment	<u><u>\$ 1,470</u></u>

(E) Salaries and Wages – Employees. South Hopkins accrued \$313,101 for test-year employee wages, of which it expensed \$305,118 and capitalized \$7,983 as Utility Plant in Service (“UPIS”) for new meter installations. Staff determined that an additional \$2,017 should be reclassified from expenses to UPIS to properly account for wages incurred to install new meter connections. As shown below, this reclassification produces an expense ratio of 96.806 percent and a capitalization ratio of 3.194 percent.⁸

Payroll Expense	\$ 305,118	(2,017)	\$ 303,101	96.806%
Capital	7,983	2,017	10,000	3.194%
	<hr/>			
Total	<u>\$ 313,101</u>		<u>\$ 313,101</u>	<u>100.000%</u>

To calculate the capitalization adjustment, Staff assumed that the total meter connection costs were equal to the tap fees collected by South Hopkins, in the amount of \$20,000 (\$800 tap fee x 25 taps), to recover the cost of the installations. Ideally, each expense account that contains installation costs, (i.e., employee wages, employee benefits, materials and supplies, transportation costs, insurance, and depreciation on equipment) would be reduced by a portion of the capitalized costs, but for simplicity, Staff decreased only two accounts, the wages expense account and the materials and supplies expense account, each by one half of the connection costs.

Staff also adjusted test-year wages to account for South Hopkins’s current level of employees and current wage rates. Currently, South Hopkins has eight full-time employees and one part-time employee. Staff determined total pro forma wage

⁸ This reclassification forms the basis for the expense and capitalization ratios used by the Staff. It is not used to reduce test-year payroll expense for the purpose of calculating the wage adjustment.

expense to be \$308,560 by applying the current pay rate of each employee to the actual hours each employee worked during the test year. Staff's calculations are shown below.

Position & Title	2015 Wages		2014 Hours		Total Salaries
	Regular	Overtime	Regular	Overtime	
Superintendent					\$ 57,000
Maintenance	13.25	19.88	2,080	71.50	28,981
Office Clerk	15.80	23.70	2,080		32,864
Maintenance	13.50	20.25	2,096	75.50	29,825
Asst. OM	18.15	27.23	2,080	3.00	37,834
Maintenance	16.75	25.13	2,136	88.00	37,989
Office Manager					43,500
Maintenance	21.30	31.95	2,104	74.00	47,180
Maintenance	2013 Hours	8.25	12.38	433	3,568
Total Pro Forma Salaries and Wages Employees					318,741
Multiplied by: Test-Year Expense Ratio					96.806%
Net Pro Forma Salaries and Wages - Employees					308,560
Less: Reported Salaries and Wages Employees					(305,118)
Pro Forma Adjustment					\$ 3,442

(F) Employee Pensions and Benefits. South Hopkins reported \$115,791 for test-year Employee Pensions and Benefits expense. The County Employees Retirement System ("CERS") employer contribution rate that became effective on July 1, 2015, is 17.06 percent.⁹ Using the current employee insurance premiums that are paid on behalf of all current full-time employees and the July 1, 2015 CERS contribution rate, Commission Staff calculates a pro forma level of Employee Pensions and Benefits expense of \$121,764. As shown below, Staff is increasing employee pensions and benefits by \$5,973.

⁹ <https://kyret.ky.gov/employers/Monthly%20Reporting/Pages/Contribution-Rates.aspx>

Pro Forma Retirement	\$ 53,768
Pro Forma Employee Insurance	<u>67,996</u>
Pro Forma Employee Pensions and Benefits	121,764
Less: Reported Employee Pensions and Benefits	<u>(115,791)</u>
Pro Forma Adjustment	<u><u>\$ 5,973</u></u>

Staff's adjustment excludes vision and dental insurance premiums paid on behalf of South Hopkins's commissioners. In Case No. 2003-00224,¹⁰ the Commission denied the recovery of the costs of employee benefits¹¹ that a district generally provided only to full-time employees, but which the district also provided to members of its Board of Commissioners. The Commission found, since members of the Board of Commissioners attended only one board meeting per month and were not required to work 40-hour work weeks, that they were part-time employees. As South Hopkins did not provide its other part-time employees with comparable benefits, Staff eliminated the costs of the commissioner benefits from pro forma operations.

(G) Changes to Wholesale Purchase Water Rates. Effective July 1, 2014, Dawson Springs increased its wholesale rate from \$1.7257 per thousand gallons to \$1.8702 per thousand gallons. Effective March 1, 2015, Madisonville increased its wholesale rate from \$3.71 per thousand gallons to \$3.95 per thousand gallons. South Hopkins reported its Water Audit Recovery Charge ("WARC") of \$57,154 in its test-year purchased water expense.

¹⁰ Case No. 2003-00224, *Application of Northern Kentucky Water District for (A) An Adjustment of Rates; (B) A Certificate of Public Convenience and Necessity for Improvements to Water Facilities if Necessary; and (C) Issuance of Bonds* (Ky. PSC June 14, 2004) at 11-12.

¹¹ Employee health insurance, life insurance, and dental insurance coverages.

As shown below, Staff determined that test-year purchased water expense should be decreased by \$23,449 to account for the current wholesale rates paid by South Hopkins and to eliminate the WARC from test-year operating expenses. The detailed explanation of the WARC is contained in Section (I), WARC.

	Test-Year Purchases - Gallons	Current Rate per 1,000 Gallons	Pro Forma
Dawson Springs	332,544.120	\$ 1.8702	\$ 621,924
Madisonville	6,072.000	\$ 3.95	23,984
Pro Forma			645,908
Less: Test Year			(669,357)
Decrease			\$ (23,449)

(H) Excess Water Loss. 807 KAR 5:066, Section 6(3), limits water loss to 15 percent for ratemaking purposes unless an alternative level is found reasonable by the Commission. Staff calculated South Hopkins’s test-year water loss to be 17.75 percent, or 2.75 percent above the allowable limit, as shown below:

Water Purchased, 2012 Annual Report	338,616,120
Volume Sold During the Test Year	(271,873,593)
Water Used for Line Flushing	(6,453,000)
Fire Department Usage	(190,000)
Water Loss	60,099,527
Divide by: Total Purchased	338,616,120
Percent Lost	17.75%
Allowable Water Loss	-15.00%
Excess Water Loss Percentage	2.75%

With the adjustments shown below, Staff removed from test-year operations the cost of purchasing and pumping the excess water loss.

	Purchased Water	Purchased Power
Test-Year	\$ 669,357	\$ 54,131
Less: Purchased Water Rate Decrease	(23,449)	
Test-Year Subject to Water Loss Adjustment	645,908	54,131
Times: Water Loss in Excess of 15 Percent	-2.75%	-2.75%
Decrease	\$ (17,762)	\$ (1,489)

(l) WARC. South Hopkins's purchased water contract with Dawson Springs includes a true-up mechanism referred to as the WARC. Dawson Springs calculates the WARC by comparing its cost to provide water to South Hopkins to the revenue it receives from South Hopkins at the contracted rate.

The WARC is calculated by an independent Certified Public Accountant as part of Dawson Springs' annual financial audit. Dawson Springs applies the entire amount of the WARC to the bill delivered to South Hopkins in the month following completion of the audit. In October 2014 Dawson Springs assessed a WARC charge to South Hopkins of \$57,154, which includes the back billing of the increase in the wholesale rate for water purchased in July 2014 and August 2014 of \$8,095.¹²

South Hopkins is required to pass the WARC through to its wholesale customers and its retail customers using different methods. In accordance with its wholesale water contracts, South Hopkins passes the WARC through to its wholesale customers in the month following Dawson Springs' assessment of the WARC. The pass-through to retail customers is performed over multiple billing periods. The Commission's Order in Case No. 2010-00074¹³ required that a WARC charge be collected from retail customers over

¹² \$3,913 (July 2014) + \$4,182 (August 2014) = \$8,095.

¹³ Case No. 2010-00074, *Application of South Hopkins Water District for Approval of a Proposed Increase in Rates for Water Service* (Ky. PSC Sept. 22, 2010) at 10.

a 12-month period, while a WARC refund is to be made over a two-month period in accordance with 807 KAR 5:068, Section 7. In all instances, the WARC pass-through by South Hopkins is shown as a separate line item from all other charges or credits on a customer's bill.

Because the WARC pass-through is separate from South Hopkins's retail and wholesale water service rates, its effects would generally be removed from the test year so that it has no impact on the calculation of South Hopkins's water service rates. However, when South Hopkins calculated the WARC for the 2014 charge, South Hopkins failed to include the July 2014 and August 2014 cost increase of \$8,095. If this is not included in the base rate, South Hopkins will not be able to recover the total WARC that it was assessed by Dawson Springs. Staff finds that the unrecovered water cost should be amortized and recovered through retail rates during the three-year period the rates established in this proceeding will likely be in effect. Accordingly, Staff has increased operating expenses by \$2,698.¹⁴

(J) Materials and Supplies. During the test-year South Hopkins capitalized materials and supplies in the amount of \$3,250 for the installation of new meter connections. As previously discussed in Reference Item (E), Staff determined that the appropriate amount is \$10,000. Accordingly, Staff decreased test-year materials and

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Total Unrecovered Water Cost	8,095
Divided by: Amortization Period	<u>3</u>
Pro Forma Adjustment	<u>\$ 2,698</u>

supplies expense by \$6,750.¹⁵ Depreciation to be accrued on the additional capital costs are include in Staff's calculation of pro forma depreciation expense.

(K) Depreciation. South Hopkins reported test-year depreciation expense of \$76,577. During the test year, South Hopkins placed into service \$179,287 of capital assets and recorded a partial-year's depreciation expense for each asset. As shown in the table below, Staff is increasing depreciation expense by \$7,496 to reflect a full year's depreciation for these capital assets.

Description	Cost/Basis	Depreciation Lives	Depreciation Expense		
			Staff	District	Adjustment
Plant Purchased in 2014:					
Software	\$ 1,378	5.0	\$ 276	\$ 184	\$ 92
Okidata Laser Printer	1,351	5.0	270	113	157
2014 F150	17,014	7.0	2,431	608	1,823
Mini Bar	249	7.0	36	6	30
2014 F150	17,112	7.0	2,445	0	2,445
Heater	525	17.5	30	22	8
B&S 3000 PSI 5.0 GPM	379	17.5	22	4	18
Telemetry System	111,310	25.0	4,452	2,226	2,226
Software	240	10.0	24	2	22
Septic Tanks	29,729	25.0	1,189	514	675
Full-Year Depreciation					<u>7,496</u>

As previously discussed at Reference Items (E) and (J), Staff determined that South Hopkins understated the cost of test-year meter installations by \$8,767. Staff increased test-year depreciation by \$219, as calculated below, to account for depreciation that will accrue on the additional meter installation costs.

15	
Labor - Capitalized	\$ (10,000)
Less: Capitalized per Audit	<u>3,250</u>
Remaining to be Capitalized	<u>\$ (6,750)</u>

Additional Wages Capitalized by Staff, Ref. Item (E)	\$ 2,017
Additional Materials and Supplies Capitalized by Staff, Ref. Item (J)	<u>6,750</u>
Total Additional Meter Installation Costs Capitalized by Staff	8,767
Divide by: Depreciable Life	<u>40</u>
Increase to Depreciation Expense	<u><u>\$ 219</u></u>

(L) Amortization of Tank Inspections. In 2013, South Hopkins contracted with Wet or Dry Water Tank Inspection Services to perform inspections on all tanks at a total cost of \$3,250. In Case No. 2013-00428,¹⁶ Staff found that contracted tank inspections are routinely performed every five years and based on this finding, increased amortization expense by \$650 to reflect amortizing the tank inspection fees over five years.¹⁷ Staff is increasing amortization expense by \$650 to reflect the continued amortization of the tank inspections.

(M) Taxes Other Than Income Tax. South Hopkins reported \$29,168 for test-year Taxes Other Than Income. This amount included payroll taxes of \$26,694 and the Public Service Commission's assessment of \$2,474. As shown below, Staff decreased payroll taxes by \$918.

¹⁶ Case No. 2013-00428, *Alternative Rate Adjustment of South Hopkins Water District* (Ky. PSC Apr. 2, 2014), Staff Report at 17.

¹⁷

Cost of Tank Inspection	\$ 3,250
Amortize: 5 Years	<u>5</u>
Annual Recognition	<u><u>\$ 650</u></u>

Employee Pro Forma Wages	\$ 318,741
Commissioner Wages	<u>18,200</u>
Total Wages Subject to Payroll Taxes	336,941
Times: Tax Rate	<u>7.65%</u>
Payroll Tax Expense	25,776
Less: Test Year Payroll Tax Expense	<u>(26,694)</u>
Decrease	<u>\$ (918)</u>

Overall Revenue Requirement and Required Revenue Increase

The Commission has historically applied a DSC method to calculate the Overall Revenue Requirement of water districts and water associations. This method allows for recovery of: 1) cash related pro forma operating expenses; 2) recovery of depreciation expense, a non-cash item, to provide working capital;¹⁸ 3) the average annual principal and interest payments on all long-term debts, and 4) working capital that is in addition to depreciation expense. A comparison of South Hopkins's and Staff's calculation of the Overall Revenue Requirement and Required Revenue Increase using the DSC method is shown below:

¹⁸ The Kentucky Supreme Court has held that the Commission must permit a water district to recover its depreciation expense through its rates for service to provide internal funds for renewing and replacing assets. See *Public Serv. Comm'n of Kentucky v. Dewitt Water Dist.*, 720 S.W.2d 725, 728 (Ky.1986). Although a water district's lenders require that a small portion of the depreciation funds be deposited annually into a debt reserve/depreciation fund until the account's balance accumulates to a required threshold, neither the Commission nor the Court requires that revenues collected for depreciation be accounted for separately from the water district's general funds or that depreciation funds be used only for asset renewal and replacement. The Commission has recognized that the working capital provided through recovery of depreciation expense may be used for purposes other than renewal and replacement of assets. See Case No. 2012-00309, *Application of Southern Water and Sewer District for an Adjustment in Rates Pursuant to the Alternative Rate Filing Procedure for Small Utilities* (Ky. PSC Dec. 21, 2012).

	South Hopkins	Staff
Pro Forma Operating Expenses	\$ 1,439,536	\$ 1,409,646
Plus: Average Annual Debt Principal and Interest Payments	42,378	42,378
Debt Coverage Requirement	<u>8,476</u>	<u>8,476</u>
Total Revenue Requirement	1,490,390	1,460,500
Less: Other Operating Revenue	(58,998)	(56,068)
Non- Operating Revenue	0	0
Interest Income	<u>(3,318)</u>	<u>(3,318)</u>
Revenue Required from Rates	1,428,074	1,401,114
Less: Normalized Revenues from Water Sales	<u>(1,353,871)</u>	<u>(1,353,881)</u>
Required Revenue Increase/(Decrease)	<u>\$ 74,203</u>	<u>\$ 47,233</u>
Percentage Increase	<u>5.48%</u>	<u>3.49%</u>

(1) Average Annual Principal and Interest Payments. South Hopkins has two outstanding bond series payable to the United States Department of Agriculture Rural Development ("RD"). In its Application, South Hopkins requested recovery of the three-year average principal and interest payments due in 2015, 2016, and 2017. Staff agrees that the \$42,342 requested by South Hopkins represents, in all material respects, the average annual debt payments that will be made in each year that the water rates approved by the Commission in this proceeding will be in effect.

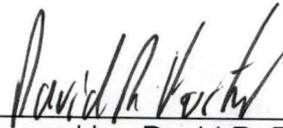
(2) Additional Working Capital. RD requires that South Hopkins charge rates that produce net revenues that are at least 120 percent of its average annual debt payments. The DSC method, as historically applied by the Commission, includes an allowance for additional working capital that is equal to the minimum net revenues required by a district's lenders that are above its average annual debt payments. In this case, Staff agrees with the amount requested by South Hopkins as calculated below.

<u>Additional Working Capital</u>	
Average Annual Debt Payments	\$ 42,378
Multiplied by: DSC Coverage Ratio	<u>120%</u>
Required net Revenues	50,854
Less: Average Annual Debt Service	<u>(42,378)</u>
Allowance for Additional Working Capital	<u>\$ 8,476</u>

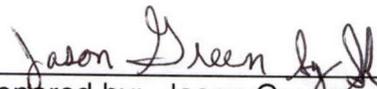
Signatures



Prepared by: Mark C. Frost
 Financial Analyst, Water and Sewer
 Revenue Requirements Branch
 Division of Financial Analysis



Prepared by: David P. Foster
 Financial Analyst, Water and Sewer
 Revenue Requirements Branch
 Division of Financial Analysis



Prepared by: Jason Green
 Water and Sewer Rate Design Branch
 Division of Financial Analysis

ATTACHMENT
STAFF REPORT, CASE NO. 2015-00154
RATES CALCULATED BY STAFF

Monthly Rates

5/8 X 3/4-Inch Meter

First	1,000	gallons	\$ 10.54	Minimum bill
Next	9,000	gallons	5.62	per 1,000 gallons
Next	10,000	gallons	5.23	per 1,000 gallons
Next	30,000	gallons	4.83	per 1,000 gallons
All Over	50,000	gallons	4.09	per 1,000 gallons

1-Inch Meter

First	10,000	gallons	\$ 61.12	Minimum bill
Next	10,000	gallons	5.23	per 1,000 gallons
Next	30,000	gallons	4.83	per 1,000 gallons
All Over	50,000	gallons	4.09	per 1,000 gallons

2-Inch Meter

First	20,000	gallons	\$ 113.42	Minimum bill
Next	30,000	gallons	4.83	per 1,000 gallons
All Over	50,000	gallons	4.09	per 1,000 gallons

3-Inch Meter

First	50,000	gallons	\$ 258.32	Minimum bill
All Over	50,000	gallons	4.09	per 1,000 gallons

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